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No. 90-1881

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

FRANKLIN FEDERAL SAVINGS BANK, *et al.*,
Petitioners,

v.

DIRECTOR, OFFICE OF THRIFT SUPERVISION, *et al.*,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

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BRIEF OF SECOR BANK, FEDERAL SAVINGS BANK, AS AMICUS CURIAE, IN SUPPORT OF PETITIONERS

EDWARD M. SELFE
201 Office Park Drive
Birmingham, Alabama 35202-2087
(205) 877-0410
Counsel of Record for Secor Bank, Federal Savings Bank

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TABLE OF CONTENTS

	Page
TABLE OF AUTHORITIES	ii
INTEREST OF SECOR BANK AS AMICUS CURIAE	1
A. Posture of the Case	1
B. Posture of Secor Bank, as Amicus Curiae	2
REASONS FOR GRANTING THE WRIT	4
I. AN EARLY DECISION BY THIS COURT WILL SUBSTANTIALLY REDUCE EXISTING LITIGATION AND AVOID EXTENSIVE FUTURE LITIGATION IN THE FEDERAL DISTRICT COURTS	4
II. AN EARLY DECISION BY THIS COURT UPHOLDING CONTRACTS PROVIDING FOR REGULATORY TREATMENT OF CAPITAL WILL ENCOURAGE PRIVATE INVESTORS TO ASSIST IN THE RECOVERY OF FINANCIAL INSTITUTIONS	7
CONCLUSION	8
APPENDIX:	
Thrift Bulletin 38-2a dated May 24, 1991, issued by Office of Thrift Supervision	1a

TABLE OF AUTHORITIES

CASES: Page

Northeast Savings, F.A. v. Director, Office of Thrift Supervision, et al., No. 89-3288 (JHG), United States District Court, District of Columbia (July 16, 1991) 6

Winstar Corporation and United Federal Savings Bank v. United States, No. 90-8C, United States Claims Court, 21 Cl. Ct. 112, 59 U.S.L.W. 2106 (July 27, 1990) 6

LEGISLATIVE HISTORY:

Subtitle D of Title I of H.R. 6, Federal Deposit Insurance Corporation Improvement Act of 1991, as reported on June 28, 1991 by House Banking Committee 6

MISCELLANEOUS:

Thrift Bulletin 38-2a dated May 24, 1991, issued by Office of Thrift Supervision 4

Crovitz, "With Lawsuits Like These, the Thrift Crisis Could Be Forever", Wall Street Journal (June 5, 1991 at p. A13) 8

BNA's Banking Report, Vol. 56, No. 24, p. 1142 (June 17, 1991) 8

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INTEREST OF SECOR BANK AS AMICUS CURIAE *

A. Posture of the Case

Petitioners seek review of a judgment of the United States Court of Appeals for the Sixth Circuit that reversed a decision of the United States District Court for the Eastern District of Tennessee. The district court, finding that petitioners entered into a valid and binding contract with the government, and finding further that

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* In accordance with Rule 37.2 of the Rules of the United States Supreme Court, Secor Bank has obtained the written consent of all parties to file a brief in support of Franklin Federal's petition for certiorari. These written consents have been filed with the clerk of this Court.

Congress expressly preserved the contract in FIRREA, enjoined the respondent government agencies from taking any action inconsistent with their obligations under the contract. The Sixth Circuit reversed, concluding that, if petitioners had a contract with the government, FIRREA abrogated it.

B. Posture of Secor Bank, as Amicus Curiae

Secor Bank is a publicly held federal savings bank (3000 stockholders) organized under the laws of the United States with its principal office located in Birmingham, Alabama. Its stock is traded on NASDAQ. It has 60 full service branches located in Alabama, Louisiana and Florida. Prior to August 9, 1989, FHLBB and FSLIC were the regulators of Secor Bank. After such date, the Office of Thrift Supervision (OTS) became the primary regulator of Secor Bank, and the Federal Deposit Insurance Corporation (FDIC) became the secondary regulator of Secor Bank. As of June 30, 1991, Secor Bank had total assets of 2.1 billion dollars and stockholders' equity of 122 million dollars (including preferred stock) based upon generally accepted accounting principles.

In December, 1987, Secor Bank acquired First Financial Bank, FSB, New Orleans, Louisiana ("First Financial") and First Federal Savings Bank, Slidell, Louisiana ("Slidell") in supervisory mergers. These institutions were insolvent, federally chartered savings associations insured by FSLIC. In connection with these supervisory mergers, the FHLBB authorized FSLIC to provide financial assistance and indemnifications to Secor Bank, including contractual provisions for regulatory treatment of capital contributions made by FSLIC. FHLBB approved such mergers only if the cost of the merger was less than the cost of liquidating the insolvent thrift.

The financial assistance and indemnifications provided by FSLIC included the contributions of (i) $57,085.00 in

cash through the purchase of preferred stock, (ii) a $94,689,000 interest bearing note and (iii) indemnification with respect to anticipated losses on acquired assets. The assistance agreement specifically provides that FSLIC and FHLBB agreed to treat the capital contributions by FSLIC as regulatory capital. In accordance with that contract, Secor Bank has filed its reports with OTS showing these capital contributions as regulatory capital. These FSLIC capital contributions are also referred to as "qualifying supervisory goodwill" for purposes of regulatory capital. 12 CFR Section 567.1(w).

On May 24, 1991, OTS issued Thrift Bulletin 38-2a stating that contracts which permit the use of supervisory goodwill for regulatory capital purposes are not to be followed in determining a savings association's regulatory capital. OTS stated that the Financial Institutions Reform, Recovery and Enforcement Act of 1989 ("FIRREA"), Public Law No. 101-73, 103 STAT. 183, enacted on August 9, 1989, which required the phase-out of supervisory goodwill as regulatory capital over a five year period ending December 31, 194, applied to savings associations with contracts such as that held by Secor Bank.

If the Supreme Court determines that FIRREA did not abrogate these contracts, Secor Bank currently will meet its fully phased in regulatory capital requirements. If the Supreme Court does not so hold, Secor Bank will not meet the fully phased in regulatory capital requirements at this time, and may not be able to meet its minimum regulatory capital requirements without a very severe reduction in assets to the substantial detriment of the public stockholders of Secor Bank. Therefore, Secor Bank desires to urge the Supreme Court to hold that FIRREA did not abrogate contracts made by FHLBB and FSLIC in connection with supervisory mergers.

As of June 30, 1991, Secor Bank had common stockholders' equity determined in accordance with generally

accepted accounting principles of $68,000,000 which was owned by more than three thousand stockholders. It has had profitable operations in four of the last five years, and had highly profitable operations for the last nine months. FHLBB and FSLIC obtained what they sought, the merger of two insolvent thrifts into a profitable institution at a substantial savings to FSLIC.

If the contract made by FHLBB and FSLIC with Secor Bank is not enforced, the public stockholders of Secor may be severely damaged. Any litigation by Secor Bank to enforce its contract will be affected by the decision of the Supreme Court in this litigation. In both cases, a paramount question will be whether contracts concerning supervisory goodwill executed by FHLBB and FSLIC in connection with supervisory mergers are abrogated by FIRREA. We wish to add our arguments to those of Franklin Federal in urging the Supreme Court to grant a writ of certiorari to the Sixth Circuit.

REASONS FOR GRANTING THE WRIT

I. AN EARLY DECISION BY THIS COURT WILL SUBSTANTIALLY REDUCE EXISTING LITIGATION AND AVOID EXTENSIVE FUTURE LITIGATION IN THE FEDERAL DISTRICT COURTS

Secor Bank fully supports the reasons for granting the writ stated by the petitioners. In addition, Secor Bank desires to bring to the Court's attention the enormous administrative burden and litigation expenses being placed upon savings associations and OTS and FDIC by the erroneous OTS determination that FIRREA eliminates contracts providing for the treatment of supervisory goodwill as regulatory capital. On May 24, 1991, OTS issued Thrift Bulletin 38-2a which stated as follows:

> "The Office of Thrift Supervision is applying the new capital standards to all savings associations, including those associations that have been operating under previously granted capital and accounting forbear-

ances. Section 5(t) of HOLA as amended by the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRRHEA) eliminates these forbearances. All savings associations presently operating with these forbearances, therefore, should eliminate them in determining whether they comply with the new minimum regulatory capital standards. (Any FSLIC capital contributions that resulted in the creation of goodwill will be subject to the requirements for goodwill established in the capital regulation.)

"If the association determines that it will fail its minimum regulatory capital requirements upon the elimination of capital and accounting forbearances, it must submit a capital plan to its Regional Director in accordance with the regulatory capital regulation and Thrift Bulletin 36a.

"A capital plan will not be acceptable if it includes the continuation of previously granted capital and accounting forbearances. Capital plans already submitted that propose to continue previous capital and accounting forbearances will either be disapproved, returned for revision and resubmittal, or conditionally approved with the requested forbearance denied."

We believe there are many savings associations operating in a safe and sound manner which have forbearance agreements or contracts for the treatment of supervisory goodwill as regulatory capital. If these contracts have not been abrogated by FIRREA, these savings associations will meet their minimum regulatory capital requirements and will not be obligated to submit capital plans to OTS because of a lack of regulatory capital; and those savings associations which do submit capital plans to OTS which include the continuation of supervisory goodwill for regulatory capital purposes pursuant to contracts entered into by FHLBB and FSLIC will not have their capital plans rejected by OTS for that reason.

The preparation and submission of capital plans to the OTS for savings associations with contracts for regula-

tory treatment of supervisory goodwill are highly dependent upon the correct interpretation of Section 401(g) of FIRREA. An early decision by this Court concerning the status of contracts for the regulatory treatment of supervisory goodwill under FIRREA will greatly facilitate the preparation and submission of capital plans to OTS by hundreds of associations, and will reduce substantially the amount of future litigation involving such contracts.

On June 28, 1991, the House Banking Committee of the U.S. Congress approved legislation [1] providing for early intervention and receivership or conservatorship of a savings association or a bank if its tier 1 capital (primarily common stock equity) for regulatory purposes is less than two percent of total assets. If contracts for regulatory treatment of supervisory goodwill have not been abrogated by FIRREA, savings associations having such contracts will not be subject to early intervention based upon disregarding such contracts. Again, an early decision by this Court will foreclose extensive future litigation arising out of early intervention based upon disregarding contracts for supervisory goodwill.

In addition to the thirty-four cases now pending in the federal courts involving contracts for regulatory treatment of supervisory goodwill, many more cases will be filed as savings associations are compelled by regulatory action to seek enforcement of their contracts in federal district courts. If FIRREA abrogated such contracts, as the majority opinion of the Sixth Circuit held in this case, savings institutions have a claim for breach of contract which may be pursued in the United States Claims Court.[2]

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[1] Subtitle D of Title I of H.R. 6, Federal Deposit Insurance Corporation Improvement Act of 1931, as reported on June 28, 1991 by House Banking Committee.

[2] *Winstar Corporation and United Federal Savings Bank v. United States*, No. 90-8C, United States Claims Court, 21 Cl. Ct. 112, 59 U.S.L.W. 2106 (July 27, 1990); *Northeast Savings, F.A. v. Director, Office of Thrift Supervision, et al.*, No. 89-3288 (JHG), United States District Court, District of Columbia (July 16, 1991).

This could result in billions of dollars being paid out by the U.S. Treasury to savings institutions having such contracts.

On the other hand, a decision by this Court that FIRREA did not abrogate such contracts will resolve substantially all disputes over such contracts. The savings institutions having contracts for regulatory treatment of supervisory goodwill want OTS to comply with these contracts rather than pay damages for breach of contract. This is clearly evidenced by the fact that virtually all the litigation on this matter is taking place in the federal district courts rather than in the Claims Court.

In view of the 34 cases now pending in the district courts and the additional cases that will be filed by savings institutions having such contracts, the damages that will have to be paid by FDIC may be in the billions of dollars if FIRREA is held to abrogate such contracts. The FDIC is currently seeking approval from Congress for billions of dollars to be expended by the FDIC and the RTC in resolving insolvent savings associations. Such damages will be in addition to the funds currently being sought by FDIC.

An early decision by this Court to the effect that FIRREA did not abrogate such contracts would relieve FDIC from the risk of large losses arising from claims for breach of contracts. The longer the resolution of this litigation over such contracts is delayed, the greater the costs of this litigation and the administrative burdens on OTS, FDIC and the thrift industry.

II. AN EARLY DECISION BY THIS COURT UPHOLDING CONTRACTS PROVIDING FOR REGULATORY TREATMENT OF CAPITAL WILL ENCOURAGE PRIVATE INVESTORS TO ASSIST IN RECOVERY OF FINANCIAL INSTITUTIONS

FDIC and the Resolution Trust Corporation ("RTC") as well as OTS want private investors to invest equity capital in troubled financial institutions. *E.g.*, In the

July 5, 1991 issue of the Wall Street Journal, it is reported that Southeast Banking Corporation, a 12 billion dollar bank holding company is seeking financial assistance from federal regulatory agencies. At a press conference on June 12, 1991, Timothy Ryan, Director of OTS, announced that OTS wanted to induce private investment in savings institutions needing added capital by matching such investment with government assistance. See BNA's Banking Report, Vol. 56, No. 24 at p. 1142 (June 17, 1991). Private investment will be very difficult to accomplish so long as there is investor concern that contracts made with these agencies may not be enforceable.

An early decision by this Court that FIRREA did not abrogate contracts for regulatory capital requirements will encourage private investors to assist in the recovery of financial institutions. It has been suggested that the thrift crisis will last forever if lawsuits such as this are not quickly resolved. *Crovitz*, "With Lawsuits Like These, the Thrift Crisis Could Be Forever," Wall Street Journal (June 5, 1991 at p. A13).

CONCLUSION

For the foregoing reasons and the reasons stated by petitioners, we respectfully urge that the writ be granted.

Respectfully submitted,

EDWARD M. SELFE
201 Office Park Drive
Birmingham, Alabama 35202-2087
(205) 877-0410
Counsel of Record for Secor Bank, Federal Savings Bank

August 5, 1991

APPENDIX

APPENDIX

Office of Thrift Supervision

THRIFT BULLETIN

Handbook: Thrift Activities — Section:320
Subject: Capital Adequacy — TB 38-2a

May 24, 1991

CAPITAL ADEQUACY: GUIDANCE ON THE STATUS OF CAPITAL AND ACCOUNTING FORBEARANCES AND CAPITAL INSTRUMENTS HELD BY A DEPOSIT INSURANCE FUND

Summary: This Bulletin informs all savings associations that have been operating under capital or accounting forbearances that Section 5(t) of the Home Owners' Loan ct ("HOLA") eliminates such forbearances. Accordingly, these forbearances should be eliminated in determining whether an association complies with the new capital regulation. All associations that do not comply with the new capital regulation must submit a capital plan. This Bulletin also clarifies the treatment of capital instruments held by a deposit insurance fund or related entity (such as the Resolution Trust Corporation (RTC) and the FSLIC Resolution Fund (FRF)). Thrift Bulletin 38-2 (TB 38-2), dated January 9, 1990, is rescinded with the issuance of this Bulletin. The differences between TB 38-2 and TB 38-2a are in the treatment of capital instruments held by a deposit insurance fund or related entity.

For Further Information Contact:

The Regional Office in which you are located or the Policy Division of OTS, Washington, D.C.

Thrift Bulletin 38-2a

Introduction

Questions have been raised regarding the status of previously granted forbearances and waivers as well as the treatment of FSLIC-owned warrants and other capital instruments. This Bulletin provides guidance to savings associations on these matters.

Capital Compliance

The Office of Thrift Supervision is applying the new capital standards to all savings associations, including those associations that have been operating under previously granted capital and accounting forbearances. Section 5(t) of HOLA as amended by the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA) eliminates these forbearances. All savings associations presently operating with these forbearances, therefore, should eliminate them in determining whether they comply with the new minimum regulatory capital standards. (Any FSLIC capital contributions that resulted in the creation of goodwill will be subject to the requirements for goodwill established in the capital regulation.)

If the association determines that it will fail its minimum regulatory capital requirements upon the elimination of capital and accounting forbearances, it must submit a capital plan to its Regional Director in accordance with the regulatory capital regulation and Thrift Bulletin 36a.

A capital plan will not be acceptable if it includes the continuation of previously granted capital and accounting

forbearances. Capital plans already submitted that propose to continue previous capital and accounting forbearances will either be disapproved, returned for revision and resubmittal, or conditionally approved with the requested forbearance denied.

Capital Instruments Held by a Deposit Insurance Fund or Related Entity

Capital instruments owned by a party with a financial obligation to havings association will be treated in accordance with Generally Accepted Accounting Principles (GAAP), unless such instruments are defined by law to be capital (e.g., net worth certificates) or unless the FDIC Board of Directors explicitly requests that they not be subject to offset and the OTS Director approves such requests. For example, under 12 CFR 567, for the purpose of the inclusion in capital of instruments owned by the FSLIC/FRF, the FDIC, or the RTC, the Office will rely on the presentation standards established under GAAP. FSLIC/FRF, FDIC, or RTC holdings of capital instruments (including, but not limited to, warrants, preferred stock and subordinated debentures) will be required to be offset by any receivables (on the asset side of the balance sheet) from, respectively, the FSLIC/FRF, the FDIC, or the RTC for the purpose of calculating the amount of such holdings to be included in capital unless one of the exceptions noted above applies. The amount of such offset is limited to the amount of the FSLIC/FRF, FDIC, or RTC capital instrument.

When there is no offsetting requirement, the value of warrants (to the extent that such warrants, when exercised, would qualify as capital) and other capital instruments that would qualify as tangible and core capital may be counted as such unless the holder of the warrants and other instruments is a federal deposit insurance fund or related entity. If the holder of the capital instruments is a federal deposit insurance fund or related entity, then

they must be classified as supplementary capital, unless the FDIC Board of Directors explicitly requests that they be counted as tangible and core capital and the OTS Director approves such request.

/s/ Jonathan L. Fiechter
JONATHAN L. FIECHTER
Deputy Director for Washington Operations